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SUBJECT: GOAM APPROVES A THREE-YEAR TAX SYSTEM DEVELOPMENT PROGRAM

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¶1. (U) SUMMARY: On May 24, 2007, the GOAM approved a Strategic Development Program for the tax system that, over the next three years, will make significant structural, legislative and technological changes within the State Tax Service (STS). The STS has benefited from the help of USAID's Tax Improvement Project (TIP), the IMF and the World Bank in designing this new program, which aims to bolster revenue collections while improving fairness and transparency. The GOAM's approval was a specific buy-in conditionality of the IMF; the GOAM is now expected to follow a targeted revenue collection strategic plan, which many think may lead to the naming and shaming of prominent oligarch tax-deadbeats. Political will remains, as ever, an open question; the STS' role as a tool of the powerful and (therefore) rich may not be so easily left behind. END SUMMARY.

¶2. (U) Despite six consecutive years of double digit GDP growth, as well as active reforms in tax and customs administration, Armenia's Tax-to-GDP ratio (14.6 percent in 2006) remains one of the lowest among CIS countries. A recent IMF working paper on Armenia's tax potential indicated that the gap between the potential and actual tax collection in Armenia could be as high as 6.5 percent of GDP. The IMF report also provided empirical evidence that the low Tax-to-GDP ratio is the consequence of weak institutions and a large shadow economy.

¶3. (U) The STS' new Strategic Development Program includes a number of important steps aimed at closing the gap and increasing the Tax-to-GDP ratio to 20 percent by 2010. The program is specifically targeted to improve the Armenian State Tax Service's performance, raise the effectiveness and the professionalism of its employees, and reduce widespread corruption in the system. The goals of the Program also include the development of an integrated self-assessment system within the tax system, an upgrade of information technology systems, the simplification of the current tax legislation and administration, and assured unified implementation of the current legislation.

¶4. (U) The new program will require the STS, for example, to begin using third party information sources, such as banks, Social Security, and Police, to establish the real income of some large taxpayers. It also calls on STS to implement an automated system for VAT processing and refunds, which is expected to improve efficiency and customer service, and to increase VAT collections. The program calls for major reorganization and procedural reforms, especially in the "Large Taxpayers Inspectorate," which will increase transparency and accountability and hopefully make it harder for the wealthy to buy off corrupt tax inspectors. New internal controls and IT systems will contribute to the same goal.

15. (U) The Strategic Development Program also envisages that the Tax-GDP ratio be improved through the enhancement of taxation mechanisms, including improving the tools of tax computation and the documentation of business turnovers; the strengthening of control mechanisms to eliminate widespread tax evasion; the development and introduction of agricultural VAT taxation mechanisms; and the combating of illegal entrepreneurship to reduce the shadow economy.

16. (SBU) COMMENT: While STS' Strategic Plan itself enumerates some 70 points, increasing revenue boils down to collection. Nevertheless, the development and adoption of the first strategic development program is an important step forward in reforming Armenia's tax sector, improving its effectiveness and most importantly, combating widespread corruption within the system. The continuous support of the U.S. Government, IMF and World Bank, however, is required to enable successful implementation of the Program. Because the new program aims to get prominent oligarchs to pay their fair tax share, the program's success will hinge greatly on the formation of a new government following parliamentary elections that took place two weeks ago. The ultimate success of these reforms may depend, more broadly, on top leaders' unproven commitment to entrench reforms to put the STS beyond the reach of either political manipulation or cronyist favoritism. END COMMENT.

GODFREY